Intelligence MEMOS

From: Hugh O'Reilly

To: Bill Morneau, Minister of Finance

Date: April 16, 2020

Re: **Regional, Economically Important Credit Unions Must be Included in STLF**

The Bank of Canada has made a series of interventions designed to support Canada's financial system and ensure the availability of credit during the COVID-19 crisis.

These actions are important to ensure that small and medium-sized businesses survive in the short term, and that they are able to lead the economic revival that will be needed.

But there is a potential policy gap in the design of the Standing Term Liquidity Facility (STLF), which overlooks the importance of large, regional credit unions in the Canadian financial system.

In Ontario and British Columbia, large, regional credit unions are critically important lenders to small and medium-sized enterprises. The two largest credit unions in those provinces collectively serve one million Canadians and 70,000 small businesses, from local farms and coffee shops to clean energy providers and small manufacturers. They are part of the small business backbone of the Canadian economy, which employs two-thirds of the private-sector workforce.

In order to participate in the STLF, a financial institution must be a direct participant in the Large Value Transfer System (LTVS) of Payments Canada. Direct participants must satisfy the following administrative criteria: (i) be members of Payments Canada; (ii) use SWIFT; (iii) have adequate capability for its LVTS operations: (iv) have a settlement account with the Bank of Canada; and (v) be capable of entering into loan agreements with the Bank and pledging collateral in support of those loans (the "LVTS Criteria"). The only criterion large, regional economically important credit unions don't meet is having a settlement account with the Bank.

Regional economically important credit unions serve many of the people and businesses upon which any meaningful, inclusive recovery will rely. To ensure those businesses are empowered to help drive the recovery, those credit unions must be able to access the same liquidity measures as other large Canadian financial institutions. And that means they should be qualifying financial institutions for the STLF.

Canada's financial system is complex, and its key institutions are regulated by different levels of government. The Bank has intervened to provide liquidity support to its most important elements and institutions. The key mechanisms are the STLF for the chartered banks and other participants in the Large Value Transfer System (LVTS) and a Contingent Term Repo Facility (CTRF) for federally and provincially regulated institutions (pension funds, banks, securities dealers and insurance companies) with significant activity in the Canadian fixed income or money markets.

The CTRF shows that the Bank's role in maintaining financial system liquidity is not limited to areas of federal jurisdiction. Inclusion in the CTRF is based on the participation of the financial institution in certain Canadian fixed income and money markets. This suggests that those institutions must not only be systemically important, they must also be sophisticated.

But under the current design of the STLF, big credit unions do not participate directly. Instead, they participate through Central 1, a cooperative set up by member credit unions for the purpose of participating in the Canadian Payments System. While Central 1 has a relationship to its institutional members, it does not have any connection to their retail and business members. Its ability to act as an effective intermediary between the banks and big credit unions is therefore limited. Moreover, using an intermediary that serves all credit unions may create bottlenecks and information gaps that could create barriers for regional economically important credit unions to gain access to the STLF by adding an extra layer.

Obviously, in a federal system, a one-size-fits-all policy has the potential to create more problems than it solves. The Bank appears to have recognized this when it designed the CTRF. The same factors that support the design of the CTRF also apply to the STLF.

Given their outsized regional importance, excluding big credit unions from the STLF could lead to some regions suffering a greater credit contraction and slower recovery than others. Therefore, those regional economically important credit unions that are LVTS Non-Participant Partners should be allowed to participate directly in the STLF.

Leaving these major credit unions out of the STLF could, in fact, undermine the Bank's short- and long-term goals of avoiding a credit crunch and putting small and medium businesses in the best position possible to revive the post-pandemic economy.

Hugh O'Reilly is a Senior Fellow at C.D. Howe, former President and CEO of OPTrust, and a member of the Board at Vancity Community Investment Bank.

To send a comment or leave feedback, email us at blog@cdhowe.org.